



The Commonwealth of Massachusetts

**DEPARTMENT OF
TELECOMMUNICATIONS AND ENERGY**

D.T.E. 06-46

August 31, 2006

Investigation by the Department of Telecommunications and Energy on its own motion as to the propriety of the rates and charges set forth in the following tariffs: The Berkshire Gas Company, M.D.T.E. Nos. 381 through 392, filed on May 15, 2006, to become effective September 1, 2006.

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FOR: THE BERKSHIRE GAS COMPANY
Petitioner

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I. INTRODUCTION

On May 15, 2006, The Berkshire Gas Company (“Berkshire” or “Company”) filed with the Department of Telecommunications and Energy (“Department”) its third annual rate adjustment filing (“Compliance Filing”), pursuant to the performance-based regulation (“PBR”) plan approved by the Department in The Berkshire Gas Company, D.T.E. 01-56 (2002), proposing to revise tariffs M.D.T.E. Nos. 381 through 392.¹

The Company proposes a \$738,920 increase in annual normalized base revenues, which amounts to a base revenue increase of 2.74 percent, based on the price cap mechanism (“PCM”) approved in D.T.E. 01-56 (Compliance Filing at 1). If approved, the proposed rates would result in an increase of \$0.77 per month for residential gas non-heating customers using 20 therms per month in the winter season; and an increase of \$1.99 per month for residential gas heating customers using 150 therms per month in the winter season. Berkshire’s petition was docketed as D.T.E. 06-46.

Pursuant to notice duly issued, the Department sought comments on Berkshire’s Compliance Filing. On June 30, 2006, the Attorney General of the Commonwealth of Massachusetts filed comments (“Attorney General Comments”). On July 12, 2006, the

¹ Pursuant to D.T.E. 01-56, at 28-29, Berkshire is required to make annual PBR compliance filings on May 15th beginning in 2004 and continuing through the term of the Company’s price cap mechanism. The Department approved Berkshire’s first and second compliance filings in The Berkshire Gas Company, D.T.E. 04-52 (2004) and The Berkshire Gas Company, D.T.E. 05-43 (2005), respectively.

Company filed reply comments (“Company Comments”). The Company responded to three Department information requests.²

Berkshire’s PCM approved in D.T.E. 01-56 provides for an annual adjustment to the Company’s base rates using the previous year’s normalized base revenues (after service quality penalty adjustments)³ and increasing that amount by a factor comprised of an inflation factor, minus a productivity growth offset (that remains constant throughout the life of its PBR plan), plus an exogenous cost/credit factor (which the Company proposes to set at zero in the instant docket). D.T.E. 01-56, at 12. The inflation factor is calculated as the percentage change between the average of the current year’s and prior year’s four quarterly measures of the gross domestic product chain weighted price index (“GDP-PI”) as of the first quarter of the current year. *Id.* at 20-21. The source for the GDP-PI values used in calculating the inflation factor is the U.S. Department of Commerce Bureau of Economic Analysis’ (“BEA”), Survey of Current Business (“Survey”). D.T.E. 01-56 at 12.

II. COMPANY’S COMPLIANCE FILING

In its Compliance Filing, the Company calculated the inflation factor to be 3.74 percent (Compliance Filing, Att. 2, at 2, 2A). This is equal to the percentage increase from:

(a) the average of four quarterly GDP-PI values from the second quarter of 2004 to the first

² The Department, on its own motion, moves the Company’s responses to Information Requests DTE-1-1 through DTE-1-3 into the evidentiary record in this case.

³ Berkshire’s 2005 annual service quality report, filed with the Department on March 1, 2006, indicates that the Company has not incurred service quality penalties in 2005. This filing is under review by the Department. See The Berkshire Gas Company, D.T.E. 06-13 (Service Quality Report).

quarter of 2005 (“Prior Year Average GDP-PI”) to: (b) the average of four quarterly GDP-PI values from the second quarter of 2005 to the first quarter of 2006 (“Current Year Average GDP-PI”) (id.).

In calculating the Current Year Average GDP-PI, the Company used the quarterly values taken from the BEA’s Survey as of April 28, 2006 (id., Exh. DTE-1-2). The resulting average is 113.0525 (Compliance Filing, Att. 2, at 2). In calculating the Prior Year Average GDP-PI, the Company took the average of four quarterly values that were used in its previous PBR compliance filing approved in D.T.E. 05-43 (id., Att. 2, at 2, 2B). Those quarterly GDP-PI values were taken from the BEA’s Survey as of April 28, 2005 (id., Att. 2A; see D.T.E. 05-43, Compliance Filing, Att. 2, at 2A). The resulting Prior Year Average GDP-PI is 108.9800 (id.). Thus, 113.0525 minus 108.9800 equals 4.0725, divided by 108.9800 equals 3.74 percent.

Berkshire’s normalized base revenues for 2005 were \$27,013,793 (Compliance Filing, Att. 1, at 1). The Company proposes to increase 2005 normalized base revenues by 2.74 percent using its PCM (Compliance Filing at 1). Berkshire calculated the PCM rate adjustment (“PCM increase”) equal to an inflation factor of 3.74 percent minus the 1.00 percent productivity growth offset (Compliance Filing, Att. 2, at 1). D.T.E. 01-56, at 21. As noted above, Berkshire does not propose an exogenous cost/credit factor in the instant docket (Compliance Filing at 1). Applying the resulting PCM increase of 2.74 percent ($=3.74\% - 1.00\%$) to Berkshire’s 2005 normalized base revenues of \$27,013,793 results in a proposed revenue increase of \$738,920 (Compliance Filing, Att. 2, at 1).

In the course of discovery on issues raised in the Attorney General Comments, Berkshire proposed an alternative approach to determine its inflation factor. Under its alternative approach, Berkshire would begin with the inflation factor of 2.91 percent as calculated by the Attorney General, and also reconcile the prior inflation factors (presently two periods) to incorporate changes in previously published BEA information (Exh. DTE-1-3). This approach would result in a total inflation adjustment of 3.72 percent, before applying the 1.00 percent productivity growth offset (with reconciling adjustment of 0.43 percent for 2005 and 0.38 percent for 2004) (id.) [$3.72 = 2.91 + 0.43 + 0.38$]. Berkshire claims that this approach is more accurate and would include reconciling adjustments both positive and negative (id.).

III. POSITIONS OF THE PARTIES

A. Attorney General

The Attorney General asserts that the Company overstated its price cap increase because it used incorrect GDP-PI values in its price cap formula (Attorney General Comments at 2). More specifically, the Attorney General claims that the Company, by computing the Prior Year Average GDP-PI based on the same GDP-PI values used in its prior year's PBR compliance filing in D.T.E. 05-43, instead of using the GDP-PI values reported in the current BEA Survey (revised as of June 2006)⁴, overstated the resulting percentage increase in

⁴ The Current Year Average GDP-PI is the same based on the BEA Surveys as of April 28, 2006 and as of June 29, 2006 (see Exhs. DTE-1-2 and DTE-1-3).

inflation.⁵ The Attorney General calculated the inflation factor to be 2.91 percent (before deducting the 1.00 percent productivity growth offset) instead of the 3.74 percent calculated by the Company (id.). The Attorney General calculated this 2.91 percent inflation factor equal to the percentage change from the Prior Year Average GDP-PI to the Current Year Average GDP-PI, both determined using the indices in the BEA Survey revised as of June 29, 2006 (id.).

The Attorney General also claims that the Company failed to support its demand-based T-54 class normalization adjustment and its normalization adjustment for the University of Massachusetts Amherst billing adjustments (Attorney General Comments at 1). In addition, the Attorney General claims that the Company failed to address the issue of whether customers are entitled to an exogenous cost factor rate reduction to account for bonus depreciation under the Internal Revenue Code, § 168(k)-Special Allowance for Certain Property Acquired After September 10, 2001 and Before September 11, 2004 (“Bonus Depreciation”) (id.). The Attorney General concludes that, based on the above-described issues, the Department should conduct evidentiary hearings on the Company’s filing (id.).

⁵ The quarterly GDP-PI values for the most recent three years found in the Survey are revised annually at the end of July. In addition, every five years a comprehensive revision occurs where the GDP-PI values are revised to include improvements in concepts and methods. Accordingly, for a given quarter or year, different GDP-PI values could be reported in the Survey from the time the first GDP-PI values are reported for that year to the end of the five-year period when revisions and adjustments could be made. For example and as described above, the Prior Year Average GDP-PI is 108.98 when computed using the Survey filed in D.T.E. 05-43; however, it is 109.85 when computed using the current Survey (Attorney General Comments, at 2; Survey of Current Business, June 2006, at page D-51).

B. The Company

The Company claims that its Compliance Filing correctly provided the Current Year Average GDP-PI values (Company Comments at 3). The Company claims that this is consistent with the Department's prior directive, which requires the use of the average of the current year's four quarterly measures of GDP-PI values as of the first quarter of the year (id., citing: D.T.E. 01-56, at 20-21; D.T.E. 04-52, at 2).

The Company claims that, in order to more accurately reflect the percentage change from the previous year's compliance filing, it determined the Prior Year Average GDP-PI based on the GDP-PI values presented in its 2005 PBR compliance filing that was approved in D.T.E. 05-43 (id.). The Company asserts that this approach appropriately reflects ongoing "adjustments" to the GDP-PI administered by the BEA (id.).⁶

The Company argues that the Attorney General's approach to calculate the inflation factor may be confiscatory because if a different GDP-PI starting point for the annual rate adjustment was used, the rates approved in D.T.E. 05-43 would need further adjustment since the inflation factor approved in that proceeding would no longer be adequate (Company Comments at 4 n.1).⁷ The Company asserts that its approach is administratively efficient and

⁶ The Company provided a copy of "User's Guide to BEA Information" in its Comments (Company Comments at 3, Attachment A).

⁷ The Company claimed that if the BEA adjustments resulted in a reduction of the "04-05" GDP-PI values, the Company's aggregate two-year inflation adjustment would be overstated and the rates would be raised by more than the cumulative level of inflation actually experienced (Exh. DTE-1-3). Conversely, if the BEA adjustment resulted in an increase in the "04-05" GDP-PI values, the cumulative level of rate adjustment due to inflation would be understated (id.).

relies upon express Department findings, which ultimately results in appropriate base rate adjustments (id.).

Regarding the normalization adjustments, the Company argues that, although it provided the underlying calculations, the calculations were not necessary because the normalization adjustments are for illustrative purposes only, and, as such, have no effect on the proposed rates (id. at 2).

Regarding the exogenous factor adjustment for Bonus Depreciation, the Company states that this issue was raised and rejected in the Company's first annual PBR filing, D.T.E. 04-52, because the tax benefits from Bonus Depreciation are incorporated to some degree in the GDP-PI and, therefore, do not meet the PBR plan's definition of exogenous cost (id. at 2-3). Therefore, the Company contends that it did not address the Bonus Depreciation issue in this Compliance Filing and, since the Attorney General has made no additional arguments, the Department should again reject the exogenous cost rate reduction (Company Comments at 3).

The Company further argues that the Attorney General's request for an evidentiary hearing should not be granted because: (1) it was denied in the Company's two previous PBR adjustment filings; (2) an evidentiary hearing would diminish the administrative efficiencies available pursuant to a well-designed rate plan; and, (3) the Attorney General has not raised any meaningful concern with respect to the Company's 2006 filing (Company Comments at 4).

IV. Analysis and Findings

The Department will address the three issues brought forth by the Attorney General in this proceeding. The main point of disagreement between the Company and the Attorney

General is how best to calculate the level of inflation factor. Two other issues, normalization adjustments and exogenous factor rate reduction, can be readily disposed of based on the Department's recent precedent.

In the calculation of the inflation factor, both the Company and the Attorney General agree that the Current Year Average GDP-PI should be based on GDP-PI quarterly values currently available from the BEA Survey at the time of filing. This average value is equal to 113.0525 based on the BEA Survey as of April 28, 2006 (current data available at the time of the Company's filing).

The only point of contention between the Company and the Attorney General relates to the question of what edition of GDP-PI quarterly values should be used to calculate the Prior Year Average GDP-PI. The Company used the quarterly GDP-PI values available at the time of its 2005 PBR compliance filing in docket D.T.E. 05-43. The average value was 108.9800 based on the BEA Survey revised as of April 28, 2005. The increase from 108.9800 to 113.0525 is 3.74 percent. This is the Company's proposed inflation factor in the current case.

On the other hand, the Attorney General used the quarterly GDP-PI values currently available to determine the Prior Year Average GDP-PI. The resulting average value is 109.8520 based on the BEA Survey revised as of June 2006.⁸ The increase from 109.8520 to 113.0525 is 2.91 percent. This is the inflation factor proposed by the Attorney General. Hence his claim that the Company's inflation factor is overstated.

⁸ The Prior Year Average GDP-PI is the same based on the BEA Surveys as of April 28, 2006 and as of June 29, 2006 (see Exhs. DTE-1-2 and DTE-1-3).

In The Berkshire Gas Company, D.T.E. 01-56 (2001), the Department stated that: . . . consistent with Department precedent, we find that Berkshire shall calculate its inflation index as the percentage change between the average for the current year's and prior year's four quarterly measures of GDP-PI as of the first quarter of the year.

Id. at 20-21.

In its previous PBR compliance filings in D.T.E. 04-52 (2004) and D.T.E. 05-43 (2005), the Company determined the Prior Year Average GDP-PI based on the quarterly GDP-PI values taken from the BEA Survey currently available at the time of the compliance filings (Exh. DTE-1-3; see, D.T.E. 04-52 (2004), Compliance Filing, Att. 2, at 2, 2A; D.T.E. 05-43 (2005), Compliance Filing, Att. 2, at 2, 2A).⁹ The method used in these two previous PBR compliance filings is consistent with the above-noted directive of the Department.¹⁰

The Company's claim that, following the existing method would be confiscatory because of the on-going adjustments to inflation indices, has no basis. The Department has determined the appropriate method for calculating the inflation factor in Boston Gas Company, D.P.U. 96-50 (Phase II) and re-affirmed this method in D.T.E. 01-56. Each year, when base rates are set during a PBR compliance filing, the Department does not true-up the base rates

⁹ As noted above, Berkshire's PBR plan approved in D.T.E. 01-56 requires the Company to make its annual PBR compliance filing on May 15.

¹⁰ The Department notes that Boston Gas Company's method for calculating the inflation factor in its last two PBR filings, D.T.E. 04-88 and D.T.E. 05-66, is consistent with the above-noted Department directive and consistent with the Department's directive in Boston Gas Company, D.P.U. 96-50 (Phase II) at 262-273. See, D.T.E. 01-56, at 20.

established in succeeding PBR compliance filings, based on the effects of subsequent changes and adjustments to inflation indices. The same is true in any base rate proceeding.¹¹ The Department finds that the Company's proposed method is not consistent with existing Department precedent and, accordingly, rejects it.

V. CONCLUSION

For the reasons stated above and consistent with Department precedent in D.T.E. 01-56, the Department directs the Company to calculate both the Prior Year Average GDP-PI and the Current Year Average GDP-PI based on the most recent GDP-PI quarterly values available at the time of the Company's filing (see Exh. DTE-1-2). Therefore, the Department directs the Company to resubmit its PCM Plan Rate Adjustment Filing with the correct inflation factor of 2.91 percent minus the 1.00 percent productivity offset.

Turning to the issue of normalization adjustment (e.g., demand-based T-54 class normalization adjustment, including the normalization adjustment for the University of Massachusetts Amherst billing adjustments,) these adjustments are for illustrative purposes only and do not in any way affect the base rates that will be established in this proceeding. Therefore, the Department finds that the Attorney General's argument is not relevant to the requested rate adjustments in this proceeding.

¹¹ The Department permits utilities to increase their test year residual operations and maintenance expense by the projected GDP-PI from the midpoint of the test year to the mid-point of the rate year. See, Boston Gas Company, D.T.E. 03-40 (2003), at 255. The Department does not allow any changes to be made in base rates as a result of post test-year changes in inflation indices.

Regarding the issue of whether Bonus Depreciation should be treated as an exogenous cost, the Attorney General's claim that the Company did not address the issue is misplaced. This issue was addressed by the Department in the Company's first annual PBR filing, D.T.E. 04-52, where the Department found that Bonus Depreciation did not qualify as an exogenous cost because it would be incorporated to some degree in the GDP-PI and would have a broader economic effect on all companies as opposed to uniquely affecting the local gas distribution companies D.T.E. 04-52, at 11-12. Therefore, the Department finds that the Attorney General has presented no new arguments in the instant proceeding and, accordingly, the Attorney General's position is rejected. The Department finds, based on the foregoing reasons, that there is no need to hold an evidentiary hearing.

VI. ORDER

Accordingly, after due notice and consideration, it is

ORDERED: That the tariffs M.D.T.E. Nos. 381 through 392, filed by The Berkshire Gas Company on May 15, 2006, to become effective September 1, 2006, are DISALLOWED; and it is

FURTHER ORDERED: That The Berkshire Gas Company shall file new schedules of rates and charges that are consistent with the directives contained herein.

By Order of the Department,

/s/
Judith F. Judson, Chairman

/s/
James Connelly, Commissioner

/s/
W. Robert Keating, Commissioner

/s/
Brian Paul Golden, Commissioner

An appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part. Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of the twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. G.L. c. 25, § 5.